

TOWN SPORTS INTERNATIONAL HOLDINGS INC

Form 10-Q

July 31, 2014

Table of Contents

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**Form 10-Q**

**□ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

**For the quarterly period ended June 30, 2014**

**or**

**□ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

**For the Transition period from                      to                      .**

**Commission File Number 000-52013**

**TOWN SPORTS INTERNATIONAL HOLDINGS, INC.**

**(Exact name of Registrant as specified in its charter)**

|   |  |
|---|--|
| <b>Delaware</b><br><b>(State or other Jurisdiction of</b> | <b>20-0640002</b><br><b>(I.R.S. Employer</b> |
| <b>Incorporation or Organization)</b>                     | <b>Identification Number)</b>                |
| <b>5 Penn Plaza (4th Floor)</b>                           |  |
| <b>New York, New York 10001</b>                           |  |
| <b>Telephone: (212) 246-6700</b>                          |  |

**(Address, zip code, and telephone number, including area code, of registrant's principal executive office.)**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 and 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.:

|  |   |
|--|---|
| Large accelerated filer <input type="checkbox"/>   | Accelerated filer <input checked="" type="checkbox"/> |
| Non-accelerated filer <input type="checkbox"/> (Do not check if smaller reporting company) | Smaller reporting company <input type="checkbox"/>    |

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of July 25, 2014, there were 24,303,408 shares of Common Stock of the registrant outstanding.

**Table of Contents**

**FORM 10-Q**

**For the Quarter Ended June 30, 2014**

**INDEX**

|   | <b>Page</b> |
|---|-------------|
| <b>PART I. FINANCIAL INFORMATION</b>  |             |
| Item 1. <u>Financial Statements (Unaudited)</u>   |             |
| <u>Condensed Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013</u>  | 1           |
| <u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2014 and 2013</u>                  | 2           |
| <u>Condensed Consolidated Statements of Comprehensive (Loss) Income for the three and six months ended June 30, 2014 and 2013</u> | 3           |
| <u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013</u>                            | 4           |
| <u>Notes to Condensed Consolidated Financial Statements</u>   | 5           |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                              | 17          |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>   | 32          |
| Item 4. <u>Controls and Procedures</u>  | 32          |
| <b>PART II. OTHER INFORMATION</b>   |             |
| Item 1. <u>Legal Proceedings</u>  | 33          |
| Item 1A. <u>Risk Factors</u>  | 34          |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>  | 34          |
| Item 3. <u>Defaults Upon Senior Securities</u>  | 35          |
| Item 4. <u>Mine Safety Disclosures</u>  | 35          |
| Item 5. <u>Other Information</u>  | 35          |
| Item 6. <u>Exhibits</u>   | 35          |
| <u>SIGNATURES</u>   | 36          |
| EX-3.1  |             |
| EX-3.2  |             |
| EX-10.1   |             |
| EX-10.2   |             |
| EX-10.3   |             |
| EX-10.4   |             |
| EX-31.1   |             |
| EX-31.2   |             |

EX-32.1

EX-32.2

EX-101.INS

EX-101.SCH

EX-101.CAL

EX-101.DEF

EX-101.LAB

EX-101.PRE

**Table of Contents****TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****June 30, 2014 and December 31, 2013****(All figures in thousands except share and per share data)****(Unaudited)**

|   | <b>June 30,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|---|--------------------------|------------------------------|
| <b>ASSETS</b>   |                          |                              |
| Current assets:   |                          |                              |
| Cash and cash equivalents   | \$ 77,406                | \$ 73,598                    |
| Accounts receivable (less allowance for doubtful accounts of \$1,887 and \$2,309 as of June 30, 2014 and December 31, 2013, respectively) | 3,558                    | 3,704                        |
| Inventory   | 607                      | 473                          |
| Deferred tax assets, net  | 16,714                   | 17,010                       |
| Prepaid corporate income taxes  | 39                       | 6                            |
| Prepaid expenses and other current assets   | 12,269                   | 10,850                       |
| Total current assets  | 110,593                  | 105,641                      |
| Fixed assets, net   | 232,575                  | 243,992                      |
| Goodwill  | 32,739                   | 32,870                       |
| Intangible assets, net  | 651                      | 908                          |
| Deferred tax assets, net  | 17,755                   | 11,340                       |
| Deferred membership costs   | 8,076                    | 8,725                        |
| Other assets  | 9,817                    | 10,316                       |
| Total assets  | \$ 412,206               | \$ 413,792                   |
| <b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>   |                          |                              |
| Current liabilities:  |                          |                              |
| Current portion of long-term debt   | \$ 3,250                 | \$ 3,250                     |
| Accounts payable  | 5,615                    | 8,116                        |
| Accrued expenses  | 31,677                   | 31,536                       |
| Accrued interest  | 383                      | 737                          |
| Dividends payable   | 252                      | 259                          |
| Deferred revenue  | 39,269                   | 33,913                       |
| Other current liabilities   | 5,000                    |                              |
| Total current liabilities   | 85,446                   | 77,811                       |
| Long-term debt  | 310,683                  | 311,659                      |
| Dividends payable   | 495                      | 407                          |
| Deferred lease liabilities  | 57,528                   | 56,882                       |

Edgar Filing: TOWN SPORTS INTERNATIONAL HOLDINGS INC - Form 10-Q

|  |                   |                   |
|--|-------------------|-------------------|
| Deferred revenue   | 2,262             | 2,460             |
| Other liabilities  | 10,892            | 8,089             |
| <b>Total liabilities</b>   | <b>467,306</b>    | <b>457,308</b>    |
| Commitments and Contingencies (Note 12)  |                   |                   |
| Stockholders' deficit:   |                   |                   |
| Preferred stock, \$.001 par value; authorized 5,000,000 shares and no shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively |                   |                   |
| Common stock, \$.001 par value; issued and outstanding 24,303,408 and 24,072,705 shares at June 30, 2014 and December 31, 2013, respectively             | 24                | 24                |
| Additional paid-in capital   | (12,677)          | (13,846)          |
| Accumulated other comprehensive income   | 1,480             | 2,052             |
| Accumulated deficit  | (43,927)          | (31,746)          |
| <b>Total stockholders' deficit</b>   | <b>(55,100)</b>   | <b>(43,516)</b>   |
| <b>Total liabilities and stockholders' deficit</b>   | <b>\$ 412,206</b> | <b>\$ 413,792</b> |

See notes to condensed consolidated financial statements.

Table of Contents**TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****For the Three and Six Months Ended June 30, 2014 and 2013****(All figures in thousands except share and per share data)****(Unaudited)**

|   | <b>Three Months Ended<br/>June 30,</b> |             | <b>Six Months Ended<br/>June 30,</b> |             |
|---|--|-------------|--------------------------------------|-------------|
|   | <b>2014</b>                            | <b>2013</b> | <b>2014</b>                          | <b>2013</b> |
| <b>Revenues:</b>  |  |             |                                      |             |
| Club operations   | \$ 114,164                             | \$ 118,794  | \$ 228,644                           | \$ 236,929  |
| Fees and other  | 1,533                                  | 1,318       | 2,956                                | 2,347       |
|   | 115,697                                | 120,112     | 231,600                              | 239,276     |
| <b>Operating Expenses:</b>                                |  |             |                                      |             |
| Payroll and related                                       | 44,762                                 | 44,005      | 89,335                               | 88,553      |
| Club operating  | 48,618                                 | 44,116      | 98,213                               | 88,316      |
| General and administrative                                | 7,506                                  | 6,951       | 15,787                               | 13,740      |
| Depreciation and amortization                             | 11,853                                 | 12,411      | 23,651                               | 24,559      |
| Insurance recovery related to damaged property            |  | (2,500)     |                                      | (2,500)     |
| Impairment of fixed assets                                | 890                                    | 128         | 4,513                                | 128         |
| Impairment of goodwill                                    |  |             | 137                                  |             |
|   | 113,629                                | 105,111     | 231,636                              | 212,796     |
| Operating income (loss)                                   | 2,068                                  | 15,001      | (36)                                 | 26,480      |
| Interest expense  | 4,697                                  | 5,435       | 9,408                                | 10,785      |
| Interest income   |  |             |                                      | (1)         |
| Equity in the earnings of investees and rental income     | (639)                                  | (640)       | (1,240)                              | (1,249)     |
| (Loss) income before provision for corporate income taxes | (1,990)                                | 10,206      | (8,204)                              | 16,945      |
| (Benefit) provision for corporate income taxes            | (1,071)                                | 4,009       | (3,770)                              | 6,517       |
| Net (loss) income   | \$ (919)                               | \$ 6,197    | \$ (4,434)                           | \$ 10,428   |
| <b>(Loss) earnings per share:</b>                         |  |             |                                      |             |
| Basic   | \$ (0.04)                              | \$ 0.26     | \$ (0.18)                            | \$ 0.44     |
| Diluted   | \$ (0.04)                              | \$ 0.25     | \$ (0.18)                            | \$ 0.43     |

Weighted average number of shares used in  
calculating (loss) earnings per share:

|                                     |            |            |            |            |
|-------------------------------------|------------|------------|------------|------------|
| Basic                               | 24,291,375 | 24,042,947 | 24,226,271 | 23,959,567 |
| Diluted                             | 24,291,375 | 24,632,856 | 24,226,271 | 24,446,794 |
| Dividends declared per common share | \$ 0.16    | \$         | \$ 0.32    | \$         |

See notes to condensed consolidated financial statements.

Table of Contents

**TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME**

**For the Three and Six Months Ended June 30, 2014 and 2013**

(All figures in thousands)

(Unaudited)

|  | <b>Three Months Ended<br/>June 30,</b> |                 | <b>Six Months Ended<br/>June 30,</b> |                  |
|--|--|-----------------|--------------------------------------|------------------|
|  | <b>2014</b>                            | <b>2013</b>     | <b>2014</b>                          | <b>2013</b>      |
| <b>Statements of Comprehensive (Loss) Income</b>   |  |                 |                                      |                  |
| Net (loss) income  | \$ (919)                               | \$ 6,197        | \$ (4,434)                           | \$ 10,428        |
| Other comprehensive (loss) income, net of tax:   |  |                 |                                      |                  |
| Foreign currency translation adjustments, net of tax of \$0 for each of the three and six months ended June 30, 2014 and 2013, respectively.                                   | (53)                                   | 103             | 111                                  | (56)             |
| Interest rate swap, net of tax of \$384 and \$526 for the three and six months ended June 30, 2014, respectively, and (\$88) and (\$164) for the comparable prior-year periods | (557)                                  | 115             | (683)                                | 213              |
| Total other comprehensive (loss) income, net of tax  | (610)                                  | 218             | (572)                                | 157              |
| <b>Total comprehensive (loss) income</b>   | <b>\$ (1,529)</b>                      | <b>\$ 6,415</b> | <b>\$ (5,006)</b>                    | <b>\$ 10,585</b> |

See notes to condensed consolidated financial statements.

Table of Contents**TOWN SPORTS INTERNATIONAL HOLDINGS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Six Months Ended June 30, 2014 and 2013****(All figures in thousands)****(Unaudited)**

|  | <b>Six Months Ended June 30,</b> |             |
|--|----------------------------------|-------------|
|  | <b>2014</b>                      | <b>2013</b> |
| <b>Cash flows from operating activities:</b>   |                                  |             |
| Net (loss) income  | \$ (4,434)                       | \$ 10,428   |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: |                                  |             |
| Depreciation and amortization  | 23,651                           | 24,559      |
| Insurance recovery related to damaged property   |                                  | (2,500)     |
| Impairment of fixed assets   | 4,513                            | 128         |
| Impairment of goodwill   | 137                              |             |
| Amortization of debt discount  | 649                              | 478         |
| Amortization of debt issuance costs  | 584                              | 545         |
| Non-cash rental income, net of non-cash rental expense                                   | (1,241)                          | (2,806)     |
| Share-based compensation expense   | 1,132                            | 1,123       |
| (Increase) decrease in deferred tax asset  | (5,593)                          | 6,838       |
| Net change in certain operating assets and liabilities                                   | 3,154                            | 4,698       |
| Decrease in membership costs   | 649                              | 1,125       |
| Landlord contributions to tenant improvements  | 650                              | 784         |
| Increase (decrease) in insurance reserve   | 245                              | (658)       |
| Other  | 135                              | (415)       |
| Total adjustments  | 28,665                           | 33,899      |
| Net cash provided by operating activities  | 24,231                           | 44,327      |
| <b>Cash flows from investing activities:</b>   |                                  |             |
| Capital expenditures   | (16,188)                         | (12,301)    |
| Deposit received in connection with sale of building                                     | 5,000                            |             |
| Acquisition of businesses  |                                  | (2,939)     |
| Insurance recovery related to damaged property   |                                  | 2,500       |
| Net cash used in investing activities  | (11,188)                         | (12,740)    |
| <b>Cash flows from financing activities:</b>   |                                  |             |
| Principal payments on 2013 Term Loan Facility  | (1,625)                          |             |
| Cash dividends paid  | (7,666)                          | (101)       |

Edgar Filing: TOWN SPORTS INTERNATIONAL HOLDINGS INC - Form 10-Q

|   |           |           |
|---|-----------|-----------|
| Proceeds from stock option exercises                | 47        | 337       |
| Net cash (used in) provided by financing activities | (9,244)   | 236       |
| Effect of exchange rate changes on cash             | 9         | (60)      |
| Net increase in cash and cash equivalents           | 3,808     | 31,763    |
| Cash and cash equivalents beginning of period       | 73,598    | 37,758    |
| Cash and cash equivalents end of period             | \$ 77,406 | \$ 69,521 |

**Summary of the change in certain operating assets and liabilities:**

|  |         |          |
|--|---------|----------|
| Decrease in accounts receivable  | \$ 150  | \$ 3,130 |
| (Increase) decrease in inventory   | (134)   | 14       |
| Increase in prepaid expenses and other current assets                          | (284)   | (73)     |
| (Decrease) increase in accounts payable, accrued expenses and accrued interest | (3,535) | 203      |
| Change in prepaid corporate income taxes and corporate income taxes payable    | 1,571   | 98       |
| Increase in deferred revenue   | 5,386   | 1,326    |